



A guide to allocated pensions

You've accumulated a healthy balance in your superannuation account and are now looking forward to those retirement years you've been dreaming about. But what happens now? How do you ensure you are going to get the most out of your superannuation?



One option is to purchase an allocated pension with your super; to provide you with a regular and tax-effective income stream during your retirement years.

What is an allocated pension?

An allocated pension is a superannuation account that provides for your super to be paid to you as regular income, after your retirement from the workforce.

The payments made to you, known as your allocated pension, must be between minimum and maximum levels set by legislation. You can also withdraw lump sums at any time.

You can hold a range of assets in your allocated pension account, including shares, managed investments, fixed interest and cash, depending on the investment strategy you are comfortable with.

An allocated pension account can provide you with major tax savings, while offering you a large amount of income flexibility.

Tax benefits

- No tax is paid on any returns earned by the investments in your account. These tax-free earnings remain in your account to increase the value of your investment, so you can potentially receive more income with each payment or increase the life of your allocated pension.

- Investing your superannuation straight into an allocated pension enables you to defer the payment of lump sum tax, possibly indefinitely.
- Payments from your allocated pension account are assessed at ordinary marginal tax rates, but if you are over 55 or permanently incapacitated, you are also entitled to a tax rebate of up to 15%. So a pensioner on a 30% marginal rate pays only 15% tax on income received, plus the Medicare levy.
- Undeducted contributions are returned to you tax-free over the life of your pension. These are contributions that you or your spouse made into superannuation on your behalf and for which no tax deduction was claimed.
- Generally, Centrelink treats only part of the income received from an allocated pension as income so you may still be eligible for social security payments.
- Investments in your superannuation account with large unrealised gains may be able to be rolled into your allocated pension account. No tax is payable upon rolling over, and the investment can later be sold free of tax.
- Allocated pensions are assessed against the lower lump sum Reasonable Benefit Limit and, depending upon your level of superannuation benefits, may not provide the most tax effective solution in retirement.

Flexibility

- Choose your investments with your adviser, according to your personal risk profile. By investing in long-term growth assets, any returns made should, over time, result in an increase in the value of your investment.
- Vary the amount of income you receive and the frequency and timing of each payment, depending on your changing needs. This is useful if you are balancing your allocated pension income against other income sources.
- Allocated pension payments are not guaranteed at a certain level. Rather, they are linked to underlying market performance. As a result, if markets fall, your pension payments may fall from one year to the next.
- Draw a lump sum at any time, say for a holiday or emergency. You have access to your money if and when you need it.
- Allocated pensions are not guaranteed to last for your lifetime. They will cease once the account balance is exhausted.

Estate planning

An allocated pension can run for your own lifetime (subject to there being sufficient capital available to fund all payments) or revert to a beneficiary (generally your spouse) after your death. Allocated pensions are a good way to secure an income stream for your spouse, giving you peace of mind.

Case study:

George, aged 65, has just retired and has \$350,000 in superannuation. After meeting with his financial adviser, he decided to purchase an allocated pension with his superannuation funds. Under the levels set by legislation, for the first year of the allocated pension George must draw a minimum of \$22,290 and no more than \$43,210.

Let's assume George wants to receive \$30,000 pa as income and draws this amount from his pension. At marginal rates, \$30,000 of income results in tax payable of \$5,622 (including Medicare). However, George will be entitled to the 15% rebate (\$4,500), as he has not exceeded his Reasonable Benefit Limit. This reduces George's ultimate tax liability (ignoring other rebates) to \$1,122 – an effective tax rate of only 3.74%.

Jenny is also retiring at 65 and has the same superannuation balance as George. However, instead of purchasing an allocated pension with her superannuation funds, she withdraws the whole \$350,000 from her Super account. As this is treated as an eligible termination payment Jenny pays tax of \$11,203¹ on this withdrawal. She is then also subject to tax (including CGT) on any income derived from reinvesting the lump sum in her own name.

George's position would be even further improved compared with Jenny's if he had also made undeducted contributions to his superannuation account, as these are returned tax-free over the life of the pension. The balance of the pension is taxed, but remains eligible for the 15% tax rebate.

Let's assume that 12 months before his retirement, George met with his financial adviser and they decided that George should make an undeducted contribution of \$100,000 to his superannuation account. At retirement, George now has \$450,000 in superannuation to purchase an allocated pension. For the first year of the allocated pension, George will now be required to draw a minimum of \$28,660, but no more than \$55,560. Again, let's assume George wishes to draw \$30,000 pa.

As George has undeducted contributions in his pension, some of the income drawn will be returned tax-free. This amount, known as the 'deductible amount' is calculated as the total of George's undeducted contributions (\$100,000) divided by his life expectancy at the start of the allocated pension (17.7 years). This gives George an annual tax-free (or deductible) amount of \$5,650 which will be available for the life of his allocated pension.

This means that only \$24,350 of the \$30,000 pension will be taxed. Tax (including Medicare) ordinarily payable on this amount would be \$3,842. However, George will be entitled to a rebate of \$3,652 (or 15% of \$24,350), reducing his overall tax liability to \$190 – an effective tax rate of only 0.63%.

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¹ Assuming an equal pre/post 83 split and a 30% marginal tax rate

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